

# Legislative Analysis



## STATE POLICE RETIREMENT SYSTEM REVISIONS

Phone: (517) 373-8080  
<http://www.house.mi.gov/hfa>

### House Bills 6475-6477

Sponsor: Rep. Thomas A. Albert

Analysis available at  
<http://www.legislature.mi.gov>

### House Bills 6478 & 6479

Sponsor: Rep. Steven Johnson

### House Bills 6480 & 6481

Sponsor: Rep. Rob VerHeulen

**Committee: Financial Liability Reform**  
**Complete to 11-7-18**

## SUMMARY:

House Bill 6475 would amend the State Police Retirement Act of 1986 (the Act) to codify the hybrid retirement plan (Pension Plus) that has applied to Michigan State Police troopers through the employment contract negotiated with the state since June 10, 2012, but has never been enacted into statute. In addition, the bill would include provisions to revise employer contribution requirements and actuarial assumptions for the State Police Retirement System (SPRS). House Bills 6476-6481 would update references to the Act in several other statutes.

## BACKGROUND:

The MSP Pension Plus plan that has applied since June 10, 2012, is a hybrid plan with both pension (Tier 1) and defined contribution (or 401k-style, Tier 2) components that varies from the state police pension plan for troopers hired previously in the following ways:

- Increases member contribution to 4% of compensation (Formerly pension was 0% but was increased to 2% in 2013.)
- Bases final average compensation (FAC) used to calculate a pension benefit on the last 5 years of service rather than 2.
- Excludes overtime, shift differential, shift differential overtime, or bomb squad pay from FAC calculation.
- Reduces annual pension benefit from 60% of FAC after 25 years to the following formula: 2% of FAC for each year of service up to 25 years; Multiplier declines by 0.4 percentage points for each year after 25 until reaching 0% at 30 years.
- Implements minimum age requirement for retirement with 25 years of service at 55, and increases minimum age requirement with 10 years of service from 50 to 60.
- Eliminates option to participate in Deferred Retirement Option Program (DROP).
- Eliminates retiree health benefits for members and replaces it with an employer matching contribution of up to 2% of the member's compensation into a member's Tier 2 account plus a one-time lump sum payment upon termination of employment equal to either \$1,000 or \$2,000 depending on age/service.
- Provides a 50% matching employer contribution capped at 1% of the member's compensation into his or her Tier 2 account.

## DETAILED SUMMARY:

### Pension Plan Changes

Generally, the bill reflects the addition of the Pension Plus plan changes summarized above for regular retirement along with related updates regarding death and disability benefits. It also reflects previous contractually offered options for a member to choose reduced pension benefits in order to provide survivor benefits to his or her beneficiary after the member's death.

The bill would require that the state offer SPRS members an optional DC plan as an alternative to the Pension Plus plan as part of the collective bargaining process, but would not require employees to participate.

### Employer Contribution Rates

Currently, employer costs are calculated as a percentage of SPRS payroll, and there are two separate contribution rates:

- The **Normal cost rate** which represents the actuarial estimate of the cost of the benefit earned in any given year by active employees. The normal rate varies depending on which pension and retiree health care benefit plan an employee is in.
- The **Unfunded Actuarial Accrued Liability (UAAL) rate** which represents the actuarial estimate of the current shortfall in the system between the long-term value of assets and the long-term liability of previously earned benefits that will be paid out in the future.

Beginning in FY 2018-19, the bill would create a floor for the employer portion of the normal cost contribution rate charged to MSP such that the rate for each year would not fall below the prior year rate. Typically, the rate fluctuates up and down depending on the actual experience in a number of variables including, for example, investment rates of return, health care costs, and mortality rates.

Also, beginning in FY 2018-19, the bill would create a floor for the employer share of the UAAL contribution dollar sum, so that the total UAAL payment would not fall from one year to the next. [A floor ensures that any subsequent changes in either experience or actuarial assumptions that lower the UAAL result in paying off the UAAL more quickly rather than reducing the annual contributions and creates stability because making contributions that are higher than otherwise necessary in some years mitigates losses in other years.] The bill would require that the UAAL must be paid by 2038, which is an extension compared to the current 2036.

### Actuarial Payroll Growth Assumption

Up until now, the actuary had used a payroll growth assumption of 3.5%—along with assumptions for many other variables—when calculating long-term actuarial assets and liabilities. The actuary then calculates annual employer contributions based on what those assumptions determine must be contributed in any given year to meet the long-term liabilities. However, the SPRS board recently agreed to reduce that to 2.75% going forward based on actuarial recommendations from the most recent experience study.

The actuary currently uses a “level percent of payroll” amortization method to calculate the annual contribution necessary to pay off the UAAL for the remaining years of the amortization period—currently 18 more years. Under this method, the assumption is that a contribution rate based on a fixed percentage of an annually growing payroll will collect higher contributions every year, thus paying off the UAAL more slowly initially and back-loading payments more heavily toward the end of the amortization period.

However, if total payroll does not grow as quickly as the actuary assumes, as has been true for SPRS, then the calculated contribution rate will not achieve the actual annual required contribution necessary to meet those long-term obligations and the UAAL increases. SPRS payroll has grown just 1% over 10 years through FY 2016-17, but equaled 3.6% in that last year. The resulting shortfall in annual contributions adds to the UAAL and requires an increasing contribution rate.

An alternative method that may be used is a “level dollar” amortization method—which the bill would indirectly accomplish—where the annual contribution total is a fixed sum rather than a percentage of payroll. Under this method, the total contribution necessary over the remaining years of the amortization period is divided into equal annual required payments. On its own, using a level dollar amortization method eliminates any risk associated with not meeting the assumed payroll growth and allows earlier higher contributions more time to accumulate investment earnings.

Specifically, House Bill 6475 would lower the assumption for the SPRS payroll growth rate by 50 basis points each year, beginning in fiscal year (FY) 2021-22, until the assumption is zero, presumably in FY 2027-28. The bill would allow ORS and the retirement board to reduce it further by any number of additional basis points. Once the payroll growth assumption is zero, the amortization method would effectively shift to level dollar amortization because a fixed percent of payroll contribution rate on an assumed flat payroll would result in a fixed dollar contribution.

### **Experience Study**

The bill would require ORS to conduct and review an experience investigation study and adopt risk assumptions on which the actuarial valuations are to be based in consultation with the actuary and the state Treasurer at least once every 5 years.

The bill would require that by each April 1 after the periodic review of risk assumptions, ORS, on behalf of both the Department of Technology, Management and Budget and the State Treasurer, shall submit to the Legislature and post on its publicly available website a report that includes all of the following:

- Forecasted rates of return at 5%, 25%, 50%, 75%, and 95% probability levels.
- Actual rates of return for 10-, 15-, and 20-year intervals.
- Mortality assumptions.
- Retirement age assumptions.
- Payroll growth assumptions.
- Any other assumptions that have a material impact on the financial status of the retirement system.

## **FISCAL IMPACT:**

### **Pension Plan Changes**

Generally, the bill would have a minimal fiscal impact on the State because it codifies the hybrid retirement plan that has been in effect for Michigan State Police contractually since 2012.

### **Other Factors**

The fiscal impact of revising the payroll growth assumption would vary depending on the extent to which actual payroll growth meets the actuarial payroll growth assumption. Near-term state costs would increase, but long-term costs would decline.

As described above, shifting to a level dollar amortization method generally front-loads payments compared to a level percent of payroll method, which typically creates an initial increase in costs compared to what would have otherwise been anticipated. Those short-term cost increases are offset by long-term savings because contributing those funds into the system earlier also allows them to gain investment returns over a longer period.

However, the bill would also extend the amortization period from 18 to 20 years, through 2038, increasing the “interest” costs, which in the case of a pension plan are foregone investment gains.

Adding floors to both the contribution rates and UAAL contribution sums, ensures that any subsequent changes in either experience or actuarial assumptions that lower the UAAL result in paying off the UAAL more quickly rather than reducing the annual contributions and creates stability because making contributions that are higher than otherwise necessary in some years mitigates losses in other years.

The net impact of the bill’s changes would prevent a drop in costs currently anticipated in FY 2019-20, but otherwise would be relatively minimal as the reduced payroll assumption phases in. Over the long-term however, according to ORS, the bill would cost an estimated \$100.0 million over the life of the amortization period. To the extent that payroll grows more slowly than estimated, the potential cost increases would be diminished.

The figure on page 5 illustrates the actuarial estimates of the annual fiscal impact of House Bill 6375 and the table provides the detailed estimates behind the figure.

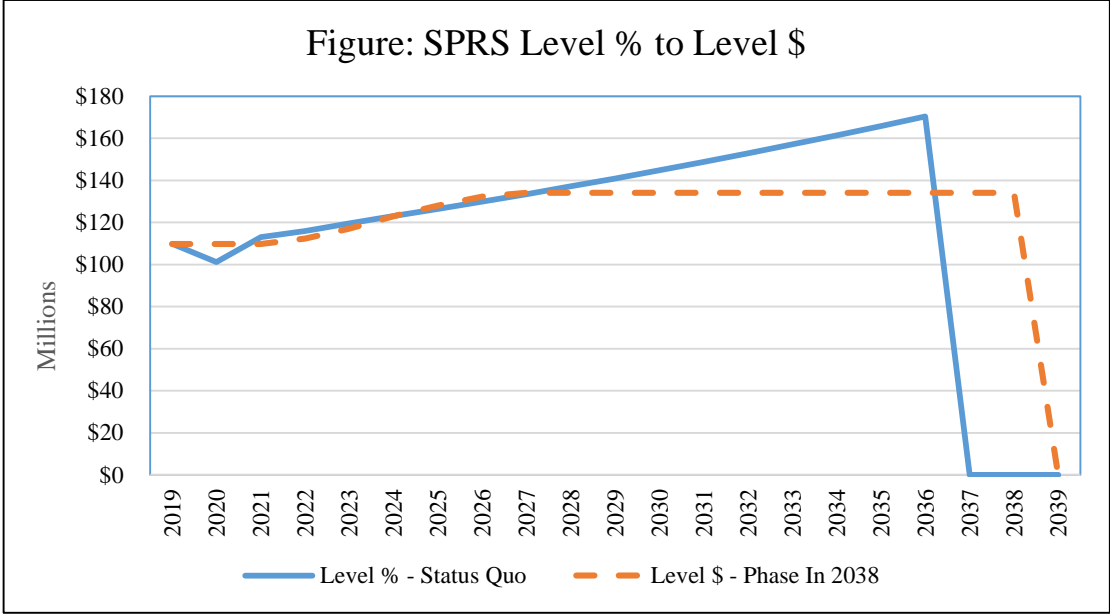
### **Appropriation**

Finally, the bill would appropriate \$535,000 for FY 2018-19 to the Department of Technology, Management, and Budget (DTMB) for ORS to administer the bill’s proposed changes. It would make the appropriation a work project, thus allowing unspent funds at the end of the fiscal year to be carried forward into subsequent fiscal years.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.



**Table: HB 6475 Estimated Fiscal Impact**

| Fiscal Year  | Level % Status Quo     | Level \$ Phase In 2038 | Difference           |
|--------------|------------------------|------------------------|----------------------|
| 2019         | \$109,844,294          | \$109,844,294          | \$0                  |
| 2020         | \$101,188,365          | \$109,844,294          | \$8,655,929          |
| 2021         | \$113,095,585          | \$109,844,294          | (\$3,251,291)        |
| 2022         | \$115,935,055          | \$112,357,723          | (\$3,577,332)        |
| 2023         | \$119,504,959          | \$117,041,140          | (\$2,463,819)        |
| 2024         | \$123,060,061          | \$122,948,173          | (\$111,888)          |
| 2025         | \$126,444,212          | \$127,964,202          | \$1,519,990          |
| 2026         | \$129,921,428          | \$132,255,818          | \$2,334,390          |
| 2027         | \$133,494,267          | \$134,156,214          | \$661,947            |
| 2028         | \$137,165,359          | \$134,156,215          | (\$3,009,144)        |
| 2029         | \$140,937,406          | \$134,156,215          | (\$6,781,191)        |
| 2030         | \$144,813,185          | \$134,156,215          | (\$10,656,970)       |
| 2031         | \$148,795,547          | \$134,156,214          | (\$14,639,333)       |
| 2032         | \$152,887,425          | \$134,156,215          | (\$18,731,210)       |
| 2033         | \$157,091,829          | \$134,156,214          | (\$22,935,615)       |
| 2034         | \$161,411,855          | \$134,156,216          | (\$27,255,639)       |
| 2035         | \$165,850,681          | \$134,156,215          | (\$31,694,466)       |
| 2036         | \$170,411,575          | \$134,156,214          | (\$36,255,361)       |
| 2037         | \$0                    | \$134,156,215          | \$134,156,215        |
| 2038         | \$0                    | \$134,156,215          | \$134,156,215        |
| 2039         | \$0                    | \$0                    | \$0                  |
| <b>TOTAL</b> | <b>\$2,558,547,629</b> | <b>\$2,658,669,056</b> | <b>\$100,121,427</b> |

Source: Office of Retirement Services